

NEWS FROM ED MARKEY

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MARKEY, DINGELL, SLAM SEC FOR LAX OVERSIGHT OF UTILITIES

Consumers, Investors Put at Risk by Commission's Neglect of Enron Abuses

WASHINGTON, D.C. – Representative Edward J. Markey (D-MA) and Rep. John D. Dingell (D-MI) today released a letter from Securities and Exchange Commission (SEC) Chairman William Donaldson revealing that the SEC has decided to continue its policy of allowing broad exemptions for certain electric and gas public utility holding companies from the provisions of the Public Utility Holding Company Act of 1935 (PUHCA), a consumer and investor protection law intended to control utility investments and diversifications. The lawmakers also released a letter they have sent to the General Accounting Office (GAO) asking it to investigate the nature and adequacy of the SEC's enforcement of the law.

“Apparently the SEC is willing to vigorously enforce PUHCA only in situations like Enron, where the company is bankrupt and all of its former management is undergoing criminal prosecution”, said Rep. Markey. “At the same time, the SEC turns a blind eye to possible future Enrons by opening the door to huge Wall Street investment firms acquiring de facto control of public utilities without having to register under the Act and comply with the consumer and investor protections that PUHCA provides. When the spotlight finally shone on Enron, it revealed that Enron had been running rings around the SEC for years simply by making false filings, knowing that the Commission had little interest in enforcing PUHCA. Now that the Enron lights have dimmed, the SEC is turning its back on PUHCA again. The inevitable result will be corporate malfeasance of the very kind that the SEC is charged with preventing.”

The SEC letter came in response to an April 21, 2004 letter from Rep. Markey, a senior Member of the House Energy and Commerce Committee, and Rep. John D. Dingell, the Ranking Democrat on the Committee, which posed a number of questions to the SEC about apparent inconsistencies in SEC enforcement of PUHCA in the aftermath of the collapse of Enron. In December 2003, the SEC ordered Enron to register with the Commission under PUHCA, denying the bankrupt companies' request for an exemption from regulation under the Act. On February 11, 2004, Reps. Markey and Dingell asked the SEC whether the reasoning used in its Enron decision was going to be applied to other public utility holding companies that also were claiming exempt status under PUHCA even though they have significant assets or operations in other states. The Markey-Dingell letter also requested that the SEC explain the basis for allowing certain investment holding companies, such as Berkshire Hathaway, KKR, or Texas Pacific Group, to acquire substantial control over utilities across the country without having to register under the Act.

In a June 28, 2004 SEC staff memorandum accompanying the Donaldson letter, Investment Management Division Director Paul Royce defended the SEC's current system of allowing companies to claim an exemption under PUHCA without ever obtaining a formal Commission grant of exempt status, arguing that “we believe this system strikes an appropriate balance” that saves “both company and Commission resources.”

The SEC acknowledged, however, that when Enron acquired Portland General Electric (PGE) in 1997, “Enron reincorporated itself in Oregon and began to claim exemption” under the Act by making annual filings asserting exempt status. Following Enron’s bankruptcy in 2002, the company “became unable to file the financial statements” required to continue claiming an exemption, so it filed for an exemption under another provision of the Act requiring formal SEC review. The SEC refused the request, thereby forcing the company to register. Royce also acknowledged that during the period when it was claiming exempt status, Enron’s filings “did not provide any information that suggested it could not qualify” for the exemption it claimed.

The SEC staff memo further noted that “the benefits that Enron and PGE obtained through Enron’s not registering could be characterized in several ways.” First, exempt companies “avoid the costs associated with complying with the Act.” More significantly, “The company also presumably benefits by not being subject to the Act’s regulatory requirements, including the Act’s restrictions on a registered holding company’s ability to engage in other businesses, its restrictions on affiliate transactions, and the requirements regarding capital and corporate structures. Enron, like any other company, likely obtained these benefits during the period that it was not registered under the Act.”

The SEC staff memo also indicated that “Between 1992 and 1999, the staff issued five no-action letters to Enron and/or its subsidiaries” assuring it that the SEC would take no enforcement action against the company for certain proposed activities or transactions. These no action letters allowed Enron to expand into electricity power marketing, vehicular natural gas activities, operation and maintenance of an electric power project in the Philippines, interconnection of individual consumers to electricity distribution facilities, and ownership of electric, gas, water, and wastewater systems at a military base in Brooklyn, New York.

Rep. Markey noted that “Had Enron been required to comply with the diversification, capital, and corporate structure requirements of PUHCA, it would have been virtually impossible for the company to have engaged in the accounting frauds involving the use of ‘special purpose entities’ to shift assets or liabilities off of its balance sheets, or engage in the fraudulent and manipulative energy trading in the Western electricity markets in 2000 and 2001. The SEC’s failure to detect Enron’s frauds before the company collapsed is in large part attributable to its willingness to allow the company to operate outside of PUHCA’s consumer and investor protections.”

The SEC staff memo also indicated that the SEC continues to favor an expansive view of utility ownership structures that have allowed companies like Berkshire Hathaway to acquire utilities without having to register under PUHCA. In 2000, the SEC issued a no-action letter to Berkshire Hathaway, finding that it would not have to register under PUHCA so long as it only held 9.9% of the voting stock of MidAmerica, a public utility, even though Berkshire reports that it has an 80.5% interest in utility operations, through MidAmerica Holdings. Reps. Markey and Dingell questioned the SEC’s allowing such investments to be exempted from PUHCA in light of earlier SEC decisions – *H.M. Byllesby & Company* and *The United Corporation* - which appeared to require registration of holding companies who have a controlling influence over electric or gas utility company or holding company, even if they own less than 10 percent of the common stock of the utility.

The SEC staff argued that “those cases are distinguishable from *Berkshire Hathaway*” because “there were not *prima facie* holding companies” under the meaning of the Act, “and the staff did not conclude, based on the facts presented in the no-action request, Berkshire Hathaway and the other companies would exert the kind of control or controlling influence that would have warranted a recommendation to the Commission that they be found to be holding companies under the Act.”

Reps. Markey and Dingell questioned this approach. In a letter released today, Reps. Markey and Dingell asked the General Accounting Office to include an inquiry into this matter in their investigation of the SEC’s administration of PUHCA, noting that “While Berkshire Hathaway is a highly successful company with a

well-respected leadership, we fear that the precedent established in this matter could be exploited by other companies in the future that might be less well-capitalized and might be tempted to exploit their control over a utility or utility holding company to engage in the type of abusive practices that PUHCA was enacted to address.”

Copies of the SEC letter and the Markey-Dingell follow-up letter to the GAO can be found at http://www.house.gov/commerce_democrats/press/108prconsumer.shtml or www.house.gov/markey.